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FAR EAST/PACIFIC BRANCH

OFFICE OF REPORTS AND ESTIMATES

CENTRAL INTELLIGENCE AGENCY

WORKING PAPER

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FAR EAST/PACIFIC BRANCH

INTELLIGENCE HIGHLIGHTS NO. 29
WEEK OF 24 NOVEMBER - 30 NOVEMBER 1948
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SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

US acquisition of Siamese tin ore may be seriously affected if plans of British tin smelters in Malaya are implemented (page 2).

Japanese production continues to show no marked improvement (page 3).

The elimination of present administrative inefficiency is vital to the stability of the Republic of Korea and to the success of a US aid program (page 3). Also, Soviet trained guerrillas are increasing pressure on South Korean security forces (page 3).

The Chinese Communist offensive has moved south following the encirclement of Haichou (page 4). SUN Fo's appointment as Premier represents no real shift in political alignment and only reflects CHIANG Kai-shek's determination to resist efforts to replace him (page 4). The Mayor of Shanghai expects a Communist occupation of Shanghai to be accompanied by chaos in the absence of protection by an international armed force (page 5). Chinese Communist emphasis on activities of US agents in China may be a prelude to a purge in the Party (page 6). The economic situation of the National Government is more precarious than last summer (page 6).

The new French High Commissioner to Indochina is believed to lack authority to make any significant changes in French policy (page 8).

The misuse of defense funds has developed into a major problem for the Siamese Government (page 8).

President Quirino and Senator Osias have joined Jose Laurel as presidential candidates in the 1949 Philippine elections (page 8).

Renewed negotiations between the Dutch and Republicans in Indonesia at least postpone contemplated "police action" (page 9).

Note: In succeeding sections of this Weekly, the following marginal notations are used:

- (1) "A", "B", or "C" --importance in B/FE's opinion, of the item, with "A" representing the most important ones.

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

UK efforts to rebuild Siamese trade may affect US tin purchases

"B"

If reported plans of British tin smelter interests in Malaya are implemented, US acquisition of Siamese tin ore will be seriously affected. The Malayan smelters which are prepared to make a more rapid payment than the US Government, plan to recapture their pre-war status as the major consumer of Siamese tin ore exports, by making payments in US dollars and by controlling all Malayan exports of mining supplies and equipment to Siam. In addition, Malayan smelters are prepared to arrange private deals with Siamese tin ore exporters which would enable the exporter to acquire more dollar exchange than would be possible by strict observation of Siamese foreign exchange controls. If the US is to maintain its tin stockpiling program in Siam, the US Embassy, Bangkok, has suggested that the Bank of England be prevailed upon to refuse to grant US dollar exchange to Malayan smelters for Siamese ore purchases or that the US and UK Governments agree as to an equitable division of Siamese ore production.

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JAPAN

Japanese production limps along. The preliminary estimate of the August '48 "C" industrial production index as 55.1 percent of the 1930-1934 base indicates no change from July. It compares favorably, however, with the August 1947 industrial production index of 41.2. Moreover, slight improvement continued in the manufacturing industries. Nonetheless, the textile group, upon which Japan has placed much hope for sorely-needed exchange, was still under 24 percent of the base period. Also, the machinery group, which under present plans is to be doubled or trebled over the base level, was only 71.8 percent. Hence, to attain even the 1930-1934 level, Japanese production still has a long way to go.

KOREA

Inexpert administration plagues Republic of Korea. The government of the Republic of Korea has thus far failed to show that it possesses the administrative efficiency necessary to cope with the serious problems of South Korean economy. Although the Assembly's delay in enacting a rice collection law admittedly imposed a handicap on government administrators, their lack of vigor in enforcing the law presents the dangerous possibility that low government foodstocks may be exhausted around the end of the year. In addition, the Agriculture Minister has raised, against the advice of food experts, the ration in Seoul in a gamble designed to stimulate grain sales to the government, thus increasing the possibility of serious food shortages this winter. In submitting budgetary estimates administrators have indicated no appreciation of the precarious fiscal status of the government and of the necessity for a balanced budget. These examples are indicative of general administrative inefficiency, the elimination of which is vital to the stability of the Republic of Korea and to the success of a US aid program.

Soviet trained guerillas threaten sabotage in South Korea. Korean Constabulary patrols have contacted a raider group of approximately 150 men, the first of several units totaling close to 1,000 men, who have been trained in North Korea for infiltration into the South to create disturbances, recruit communists and sabotage industrial installations. The objective of the first group apparently was the vital Yonwul steam power plant in Kangwon-do.

Rugged terrain along the parallel in Kangwon-do will render it virtually impossible to prevent additional units from entering South Korea. When such groups leave the hills to raid towns for food and ammunition, however, the Constabulary and police have demonstrated their ability to intercept and inflict heavy losses on the raiders. However, if it becomes necessary to maintain a number of Constabulary units in the field against the several guerilla concentrations, the uncompleted training program of the Constabulary will be seriously retarded and the guerillas will have been partially successful in dissipating Constabulary strength.

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CHINA

Hsuehou encircled--the Communists move south. The weight of the Communist Central China offensive has shifted from the area immediately east of Hsuehou to the Suhsien-Kuchen-Lingpi triangle about 50 miles to the south. Leaving a holding force composed chiefly of irregulars to contain Nationalist units around Hsuehou, the Communists opened the second phase of the battle for Central China by moving on Nationalist concentrations in the vicinity of Pangfou. The largest of these, the 12th Army Group, has already been surrounded southwest of Suhsien and, according to the Communists, is now being "annihilated." CHIANG Kai-shek has ordered the evacuation of Hsuehou but the main body of the Nationalist forces has shown a reluctance to comply. The Communists occupy advantageous positions from which heavy casualties can be inflicted on the Government troops which are notoriously inept at fighting running battles. A small group of some 10,000 to 20,000 Communists interdicted the Hsuehou-Nanking Railway north of Changpaling, just 40 miles above Nanking, and the Communists now hold about half the length of that line.

In North China the Communists continue to build up their strength in the area east of Peiping. From the area of their present concentration, they can cut the Peiping-Tientsin and Tientsin-Tangshan rail lines and thus completely throttle shipments from the Kailan coal fields. Recent reports indicate that the Government has "strategically withdrawn" from Shanhaikuan and the port of Chinghuangtao, normally the chief outlet for Kailan coal. Although no activity has been undertaken in this particular area, the Communists to the west of Peiping resumed fighting and have isolated Tatung.

SUN Fo's appointment as premier indicates that CHIANG Kai-shek is still in control of the National Government, and that efforts by certain leading party members to convince the Generalissimo to relinquish all except nominal power apparently have failed. SUN Fo, who as CHIANG's choice for the Vice Presidency last May was defeated by LI Tsung-jen, accepted the appointment after other prominent officials including HU Shih and CHANG Chun refused it. Though at various times in the past outspokenly in favor of close Sino-Soviet cooperation, SUN has become increasingly identified with the right-wing elements of the Kuomintang. In a press conference following his appointment SUN took up the plea for US aid, (which has recently been dramatized by Madame CHIANG's flight to the US,) and emphasized his Government would reflect in many ways the US point of view. He also asked for a top US military adviser such as General MACARTHUR, and stated he favored the reopening of China's inland waterways to foreign shipping, including US naval forces, though he later amended this to mean US relief ships. SUN's appointment, by checking the month-long cabinet crisis, presents a

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facade of political continuity behind which the National Government hopes to function despite its rapid deterioration. The appointment represents no real shift in political alignment and only reflects CHIANG's determination to resist efforts to displace him.

Chaos during Communist occupation of Shanghai is anticipated by Mayor K. C. WU who believes that if the battle near Pangfou goes against the Nationalists, the question of turnover of power in Shanghai may shortly arise. He has indicated that city officials, notably the police, fearing almost certain liquidation, will not remain in the city until the Communists take over. Mayor WU believes disturbances could be avoided if an international armed force provided by Britain, France, the USSR and the US were stationed in Shanghai during the interim period to assure order during the Nationalist evacuation and Communist occupation. WU reiterated that the majority of people detest the present Government and doubt that it could win against the Communists regardless of the amount of US aid forthcoming. However, he firmly believes that any US plan to do business with the Communists would be a mistake.

"B"

Soviet Embassy enlarges its staff and evacuates dependents. In addition to five Consulates in Sinkiang and two in Manchuria, the USSR maintains in China an Embassy in Nanking and Consulates in Shanghai, Tientsin, and Peiping. In the past few months the staffs of the Embassy and the three latter Consulates have been greatly enlarged, and simultaneously the wives and children of staff members have been evacuated. It is probable that the USSR anticipates considerable confusion, and perhaps violence, during the Communist occupation of these four cities, and therefore desires: a) to have at hand sufficient personnel to look after Soviet interests; and b) to remove non-essential dependents from the scene of possible violence.

"B"

Chinese officials in Taiwan may attempt to capitalize on native dislike of the National Government by seeking autonomy for the island. Governor WEI Tao-ming's increasing criticism of the National Government and unusual conferences with local military authorities possibly reflect preparations for creation of an autonomous regime in the event of Nanking's fall. Its establishment would be facilitated initially by the relatively firm control which the provincial government now exercises over Taiwan. Although such a regime would appeal to resident Chinese and many upper-class Taiwanese as promising relative stability and security from Communism, it would have difficulty in absorbing Nationalist elements which may attempt to use the island as a base of operations against the Chinese Communists. Moreover, it would probably be confronted by a popular uprising fomented by revolutionary organizations aspiring to Taiwan's complete independence from Chinese control.

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Sinkiang Government may shortly accede to the Ili demands. After steadfastly rejecting Ili demands for the past year, CHANG Chih-chung, Director of the President's Northwest Headquarters, has reportedly worked out a plan calling for: a) transfer of most of the Chinese Government troops out of Sinkiang; b) replacing Sinkiang Governor Mesud with Burkhan, a Turki regarded as acceptable to the Ili Group; c) increasing Ili Group representation in the Sinkiang Provincial Government at the expense of Chinese officials; and d) granting a much greater degree of autonomy to the natives of Sinkiang.

"B"

Such terms would satisfy the demands of the Ili dissidents, and would probably be accepted by the Ili Group as the basis for a new provincial coalition regime, including representatives of the Chinese, the Ili Group, and other native elements. Such a new coalition would be oriented toward the USSR and away from Nationalist China.

Chinese Communists adopt Soviet device to justify future purges. Twice in the past month the Chinese Communist radio has accused the "US State Department and US espionage organizations" of jointly plotting "to destroy the national liberation movements of China and other countries of Asia." The Communists claim that this US organization, including "US Strategic Services...collaborating with the Kuomintang secret police," intends to "support the 'legal government'" and encourage "'center parties,'" to work with anti-Communist socialist, trade-union and peasant elements, to create friction between "Leftist leaders" and between "national groups" throughout Asia, and to "absorb renegades from the people's movements."

"B"

The Communists declare that, "since the US secret police scheme stresses provocations within the camp of the Left, it behooves...the Left to answer with a further consolidation of its unity." This has been the favorite device of Stalin, repeatedly declaring that "the capitalist world sends us spies and diversionists," to justify the suppression or liquidation of anti-Stalinists in the USSR. In the various Soviet 'trials,' the prosecution invariably 'proved' a direct relation between the accused and the hostile outer world, especially the latter's "intelligence services." This device is doubly useful: a) to demonstrate that internal dissatisfaction with the regime must necessarily be provoked by foreign agents; and b) to afford a pretext for purging whatever groups happen to be out of favor.

The financial situation of Nationalist China is now much more precarious than it was last summer, prior to the issuance of the new currency. Price fluctuations are wild and unpredictable, increasing the hardship of consumers and making business transactions almost impossible; black-market interest rates have averaged well above 100 percent a month and, on at least one day recently reached 600 percent; more than 100,000 Shanghai workers are now on strike and may be joined

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by additional thousands whose wages have trailed far behind prices.

The "tight money" policy currently being pursued by the Central Bank has caused a temporary decline in prices in Shanghai and Nanking. The release of gold and silver by the Government also has had an effect in temporarily arresting prices and has stimulated the flow of food from country areas where the paper currency was virtually worthless. The present currency stringency is but temporary, however, since the Government is prepared to issue GY \$10 billion (present note issue GY \$2 billion) if military expenditures must be increased. Gold sales by the Government also may be short-lived since Central Bank gold stocks are limited and since the sales were more an act of Government desperation than a long-run fiscal policy.

ECA has resorted to several emergency measures to keep Nationalist urban areas supplied with food. Only through ECA borrowing of rice from Hong Kong were widespread rice riots averted in Shanghai and Nanking in mid-November. More than 70 percent of the US \$140 million authorized for food and cotton has already been delivered to China. Under the terms of the China Aid Program, the US \$39 million remaining for expenditure on food and cotton will have to be stretched out over the December-April period. The Current status of the China Aid Program follows:

<u>Program</u>	<u>Allocated</u> <u>US \$ Million</u>	<u>Delivered as of 1 December</u> <u>US \$ Million</u>
Flour and Rice	70	47
Cotton	70	54
Petroleum	50	31
Fertilizer	14	negligible
Capital Equipment	70	"
Administrative	1	--
Total	<u>275</u>	<u>132</u>

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INDOCHINA

High Commissioner's first press conference reveals few definite French plans. "B"
The new French High Commissioner for Indochina, Leon Pignon, when questioned at a recent press conference in Saigon, declared that it was his mission to negotiate agreements provided for in the 5 June Franco-Vietnamese (Baie d'Along) Agreement as well as to carry out the principles of the protocol as approved in August by the French Government and Assembly. He denied that former Annamite emperor Bao Dai was being forced to return to Indochina by a specified date, and insisted that the plans for the ex-emperor to head a Vietnam state would be discussed again when the High Commissioner goes back to Paris in mid-December. Pignon promised that he would discuss several urgent problems with President Xuan of the Provisional Central Government, and, in addition, would consider the question of French hostages held by the Viet Minh and the problem of Chinese immigration. However, as the new High Commissioner also stressed that he was unprepared to discuss economic and cultural matters or French internal politics, it is believed that he lacks authority to make any significant changes in French policy or plans for Indochina and that, as a result, the situation there is not likely to show any improvement in the near future.

SIAM

Misuse of defense funds develops into major governmental problem. "B"
scandal involving Army Deputy Commander Luang Kach's misuse of Defense Ministry funds has developed into a major problem for the Siamese Government. Not only have 15 of 25 cabinet ministers tendered their resignations, but Parliamentary sentiment against Luang Kach has also mounted to the extent that Prime Minister Phibul Songgram's position appears to be shaken. Although the Siamese press quotes Phibul as thinking of resigning, such a development is unlikely.

The major question seems to be whether Phibul is willing to risk ejecting Luang Kach, who is one of his key political supporters. It is possible that Luang Kach may be ousted from the Siamese Army, but it is doubtful that he will be forced from the political scene. If he remains, however, Phibul's relations with even a new Cabinet will probably remain tenuous.

PHILIPPINES

President Quirino and Senator Osias join Laurel as Presidential candidates. "B"
On 27 November President Quirino announced for the first time publicly that he will be a candidate for reelection on the Liberal Party ticket. His announcement brings to a total of three those who have stated their candidacy. National party conventions which will meet early in 1949, however, will actually decide upon the nominees for president.

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PHILIPPINES (continued)

Already in the field for the presidency is Jose P. Laurel, President of the Philippines during the Japanese occupation, whose candidacy was announced by the directorate of the Fused Minority Parties on 25 September. Laurel, who is intensely nationalistic, has been "available" since 10 March 1948 and has been engaged in active campaigning and adroit political maneuvering since then. His unofficial campaign has consisted chiefly of attacks upon the government for its continued failure to restore law and order, its failure to achieve economic recovery, and its pervasion with graft and corruption. He has further criticized the administration bitterly for its policy of military and economic cooperation with the US and has extended his attacks to US Far Eastern policy which he claims has disappointed and disillusioned both Filipinos and other Asian peoples.

A third candidate, also from minority ranks and a former occupation official, is Camilo Osias who was elected to the Senate on the minority ticket in November 1947. Following reported dissension between himself and Laurel, Osias announced his own candidacy on 27 November.

INDONESIA

Critical Dutch-Republican negotiations underway. Current Dutch-Republican "A" negotiations in Indonesia must resolve two major problems before a peaceful and overall settlement can be reached and a United States of Indonesia (USI) successfully established. These are: (1) the disposition of the Republican Army and the composition and employment of a proposed federal army, (2) the high command of all military forces in Indonesia. It is believed that Dutch Foreign Minister Stikker and Republic Premier Hatta could possibly come to a mutually satisfactory agreement if left to their own devices. Both men, however, are subject to strongly antagonistic pressures. The Dutch Commander in Indonesia, who has the support of conservative elements in the Netherlands delegation, has always been in favor of resuming "police action" and has been fanning Dutch public opinion with numerous and exaggerated accounts of Republican truce violations. On the otherhand, most political parties in the Republic have taken an extremely lukewarm attitude toward the negotiations and have reiterated demands which heretofore have been unacceptable to the Dutch.

A compromise is possible but the prospects of success are not bright because neither party appears to be capable of making the drastic concessions which are necessary. Although the negotiations give rise to hopes of a peaceful settlement, their chief virtue is that they postpone the contemplated police action and pave the way for further negotiations on equally thorny political and economic differences. Failure will lead to renewed violence which will indefinitely prevent economic recovery in Indonesia, place a heavy economic strain on the Netherlands, facilitate the growth of communism, and seriously accelerate the declining prestige of the US and the UN in the area.

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